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SIPDIS

DEPT FOR WHA/CAR MSEIBEL, FOR EB, AND FOR EPSC: SENRIQUEZ

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TAGS: SENV ETRD ECON EFIN NS
SUBJECT: SURINAME INTRODUCES SURINAME DOLLAR TO BOLSTER CONFIDENCE IN CURRENCY BUT WILL IT WORK?

REF: PARAMARIBO 520

¶1. Summary: On January 1, 2004, Suriname will launch its new currency, the Surinamese dollar. The new currency will be set at an exchange rate of SR$ 2.80 to one USD, versus Sf 2,800 to one USD. According to Central Bank President Andre Telting, the introduction of the new currency is meant to bolster public confidence in the local currency The GOS has enacted a number of measures to curb government spending and reduce liquidity, which Telting believes will stabilize the exchange rate while at the same time reduce inflation and local interest rates. Still, real economic stability will only come when the GOS enacts a program to encourage private sector expansion. End Summary.

GOS Introduces the Suriname Dollar

¶2. On January 1, 2004, Suriname will launch its new currency, the Surinamese dollar (SR$), removing 3 zeros from the exchange rate. In a lunch hosted by the Paramaribo Diplomatic League (PDL) attended by diplomats and representatives of NGOs, Central Bank President Andre Telting discussed the launch of the new currency and answered questions. Telting told the gathering that the introduction of the new currency was meant to bolster the Surinamese public's confidence in the local currency which had eroded due to 20 years of overspending by the GOS. The Surinamese guilder (Sf) had devalued from Sf 200 to one USD in 1990 to a high of Sf 3,600 to one USD in 2002. Telting told the assembled representatives that the GOS had chosen to rename the guilder the dollar so that Suriname's currency would be more recognizable in the region -- like Guyanese, Trinidad and Tobago, and Jamaican dollars.

¶3. As of January 1, 2004, all amounts set in Surinamese guilders will be converted to Surinamese dollars and divided by 1,000 so that the SR$ will sell at an exchange rate of SR$ 2.8 to one USD, versus the current rate of Sf 2,800 to one USD. To ease the transition for consumers, shopkeepers will be required to list prices both in the old currency and in the new currency for a period of three months. Old notes can be converted to new notes for a period of up to 6 months at commercial banks, after which exchanges will only be accepted at the Central Bank (CBvS.) These can take place for up to 30 years after an investigation into the origin of the notes, in accordance with recently introduced anti-money laundering legislation. The new law provides for all existing contracts written in guilders to be payable in Surinamese dollars and allows contracts and local prices to be set in and payable in either the local currency or a foreign currency such as the Euro or the US dollar.

¶4. The new bank notes will be in denominations of $1, $2.50, $5, $10, $20, $50, and $100. Coins, which have not been used in a decade due to hyperinflation in the 1980s and 1990s, will be accepted back into circulation since the coins are already in cents. The coins are available in denominations of 1, 5, 10, 25, 100, and 250 cents. Those coins will retain their nominal value, in what Telting called a sort of social dividend for elderly Surinamers who may still hold them and who suffered the most from Suriname's 20 years of hyperinflation which ravaged life savings and rendered pensions worthless. Telting estimated that the cost of minting new coins would exceed the cost of reusing the old coins. New sets have been ordered, he said, but only on a small scale. Telting estimated that the SR$ 1 million in coins still in circulation would not be a disturbance to the money supply because the government would not have to pay hard currency to mint new coins, reducing the cost of recirculating the coins.

Government Overspending = Hyperinflation

¶5. Telting explained that in the 1980s and 90s, gross overspending by the government led to massive devaluation of the Surinamese guilder. Telting explained that the CBvS correlated the change in Suriname's exchange rate to the rate of inflation and that by stabilizing the exchange rate,

the GOS would stabilize inflation. Suriname, Telting continued, is a "small open economy" (i.e., that Suriname imports much of its manufactured and commercial goods and, therefore, is subject to the vagaries of the world economy) with a strong import component. In 2001, the GOS was able to stabilize the exchange rate by reducing government spending, but following the 2002 civil servant pay raises (which averaged 60 percent), the guilder lost 35 percent of its value, while inflation reached 28.1 percent by year's end. Inflation continues to be a problem in 2003 with inflation running at 28.6 percent per annum in June 2003, the last month for which statistical data was available. (Note: The General Statistics Bureau (ABS) burned down in June 2003. So far, the ABS has been unable to provide economic data. See Reftel. End Note)

¶6. In 2001 the GOS enacted a law that enabled Surinamers to hold savings in foreign currencies. Because of the Surinamese guilder's historic instability and its rapid devaluation in 2002, Surinamers holdings in US dollars exceed the value of their Sf accounts. Surinamers holding on to US dollars has put further pressure on the exchange rate since not enough US dollars are available to meet market demand, Telting said. According to Telting, Surinamese confidence in the new currency will encourage Surinamers to spend their US dollars thus further reducing this pressure on the exchange rate.

Controlling Liquidity Controls Exchange Rate

¶7. Telting explained that the CBvS began implementing a program in 2002 to reduce liquidity by raising the commercial bank reserve requirement to help stabilize the exchange rate. The CBvS raised its reserve requirement in 2002 to 27.5% to stop the near free fall in the guilder when it shot from Sf 2,200 in June when exchange controls were lifted to Sf 3,600 in September. The CBvS raised the reserve requirement again in August 2003 to 35% to even further reduce liquidity. This measure has effectively blocked Sf 170 billion ($607,140 USD) for credit operations, which in turn has reduced consumer spending in general and imports in particular -- since Suriname is heavily dependent on imports for most consumer goods. By reducing liquidity over the past year, Telting explained, the GOS successfully stabilized the exchange rate at Sf 2,800 effectively eliminating the imbalance which gives rise to the parallel market. (Note: The guilder has maintained a sell rate of Sf 2,700 to one USD on the parallel market since June 2003 while the official rate is Sf 2,800. End Note.) By reducing liquidity, the local currency becomes more scarce, driving up its value, Telting said. Telting estimates that the August 2003 reserve rate hike would continue to have effects into the new year such as reducing inflation and local interest rates, which he predicted would slide in the first months after introduction of the new currency. (Note: One local commercial bank, the Hakrinbank, recently announced it would lower interest rates by 2 percent. End Note.) Telting insisted that by limiting liquidity and increasing the reserve rate for commercial banks, the CBvS would not need to intervene in the foreign exchange market and support the SR$ with hard currency. Telting also maintained that the GOS expects to eventually eliminate controls on the foreign exchange rate and go to a floating rate once the new currency is stable. The GOS is currently working on an overhaul of foreign exchange laws with the assistance of a British consultant, he noted.

Fiscal Control Measures

¶8. To shore up fiscal controls, the government has taken a number of measures. In 2002 it implemented a law to restrict GOS spending which penalizes the Minister of Finance for overspending with a 10-year sentence and Sf 2 billion ($715,000 USD) fine. The GOS is currently drafting similar legislation to restrict the CBvS president from lending excessively to the GOS. The CBvS president will face similar penalties if he lends more than 10 percent of GDP to the GOS. These measures are designed to

institutionalize accountability, to provide a mechanism to deter the gross overspending responsible for Suriname's long history of hyperinflation, and give further confidence to the GOS's ability to maintain a stable exchange rate.

New Notes Way-Laid

¶9. On December 1 the CBvS announced that notes in

denominations of SR$ 5 and higher were delayed. The SR$ 1 and 2.50 notes will be available as of January 1, as will coins. According to Embassy sources, the notes printed by a Canadian firm needed to be reprinted because the ink ran. The Central Bank maintains that it will carry out the introduction of the new currency despite this hiccup and will continue to use the old currency until replacement notes arrive.

Introduction of New Currency May
Cause Inflationary Pressures

¶10. In the past month Surinamers have expressed concern that with the introduction of the new currency, shopkeepers will be tempted to round up prices from Sf 2,800 to SR$ 3, causing additional inflationary pressure. Surinamers point to the high inflation in the Netherlands after it converted from Dutch guilders to the Euro and fear that this same phenomenon would happen in Suriname. Diplomats who attended the lunch echoed those concerns. The Indian DCM noted that the GOS is unable to monitor shops to ensure that shopkeepers don't exploit the introduction of the new currency to raise prices to cover the fuel price increases earlier this year, as well as past devaluation of the currency. Telting responded that the government would encourage the public to report any unusual price hikes.

Comment:

¶11. Suriname's adoption of the SR$ is a symbol of its efforts to further distance itself from its colonial power, the Netherlands. The adoption of the SR$ is also a strong signal of Suriname's commitment to its membership in CARICOM and its integration in the Caribbean as a partner in the Caribbean Single Market Economy (CSME.)

¶12. Comment Continued: The GOS has put together a program of fiscal controls which should go a long way toward stabilizing the value of the new currency and keeping inflation in check -- provided the GOS adheres to these measures. The Indian DCM, a trained economist, told the Embassy that in the short run, the new currency and the GOS measures to curb government spending will probably provide the returns sought. As a consumerist economy heavily dependent on imports, only strong government resolve to control inflation and the money supply, while supporting the exchange rate with hard currency, can lead to long-run stability of the local currency, he maintained.

¶13. Comment Continued: Telting's explanation of the connection between the exchange rate and inflation appears a bit simplistic. After raising the reserve requirement in 2002 and again in 2003, the exchange rate has stabilized yet inflation persists at 30 percent per annum. The real culprit in Suriname's history of hyperinflation has been the GOS's consumptive spending -- particularly on wages. With over 60 percent of the workforce in civil service and parastatal jobs, there will be continued pressure on the GOS to succumb to the anticipated 2004 round of labor strikes, especially in the run up to elections. Although 2003 was a quiet year after the 2002 strikes, there have already been rumblings among labor leaders that civil servants should expect increases. Telting, however, maintained that the GOS told labor leaders to expect only modest pay hikes -- 5 percent rather than the 60% average wage increases doled out in 2002. After two years of 30-percent inflation, it is likely that workers will want to recoop their lost earning power with commensurate wage hikes. Businesses too have suffered from inflation and can be expected to exploit this opportunity to cover their narrowed profit margins.

¶14. Comment Continued: The GOS can, in the short run, control monetary policy to keep a lid on inflation, but only economic expansion will guarantee the long-term economic stability that eludes Suriname. Still, the GOS continues to defer the hard issues that will produce a vibrant economy: public sector reform and improving investment opportunities to attract employers for Suriname's large pool of underemployed and unemployed workers. Until the GOS implements an economic policy that encourages expansion of the private sector, only sheer political will to stay the course with harsh monetary and fiscal policy will ensure Suriname's economic --and by extension, its political -- stability. End Comment.

BARNES

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